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No. 02-1281

In The

# Supreme Court of the United States

WILLIAM G. HAYS, JR., Receiver and Disbursing Agent on Behalf of Debtors, Hannover Corporation, Et Al.,

*Petitioners,*

v.

JIMMY SWAGGART MINISTRIES,

*Respondent.*

**On Petition For Writ Of Certiorari To The United States Court Of Appeals For The Fifth Circuit**

## RESPONDENT'S BRIEF IN OPPOSITION

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## QUESTIONS PRESENTED

1. Did the United States Fifth Circuit Court of Appeals, based upon the decisions of the trial court and the factual findings of the trial court, apply the proper standards under 11 U.S.C. § 548(c)?

2. Is the decision of the United States Fifth Circuit Court of Appeals in conflict with the decisions of any other circuit court of appeals?

3. Were the petitioner's due process rights violated as a result of the decision rendered by the United States Fifth Circuit Court of Appeals?

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## BRIEF IN OPPOSITION

Respondent respectfully opposes the Petition for a Writ of Certiorari to review the decision of the United States Court of Appeals for the Fifth Circuit.

## OPINIONS BELOW

*Hayes v. Jimmy Swaggart Ministries (In re Hannover Corp.)*, 2002 U.S. App. Lexis 24649 (5th Cir. 2002).

*Jimmy Swaggart Ministries v. Hayes (In re Hannover Corp.)*, 310 F.3d 796 (5th Cir. 2002).

*Hays v. Jimmy Swaggart Ministries*, 263 B.R. 203 (M.D. 1999).

## JURISDICTION

Respondent does not contest the jurisdiction of this Honorable Court.

## STATUTORY PROVISIONS INVOLVED

11 U.S.C. § 544 (West 2003)

(See Appendix A for text.)

11 U.S.C. § 548 (West 2003)

(See Appendix A for text.)

Louisiana Revocatory Act

Louisiana Civil Code of 1870, Book III, Title IV, Chapter 12, Sec. 1, Arts. 2036-2043 (West Group 2001) – Louisiana Revocatory Act.

(See Appendix A for text.)

La.C.C. Art. 2036, "Act of the Obligor that Causes or Increases His Insolvency"

(See Appendix A for text.)

La.C.C. Art. 2040, "Contracts Made in Ordinary Course of Business."

(See Appendix A for text.)

## STATEMENT OF THE CASE

### I. INTRODUCTION

Petitioner Hays makes four arguments in support of his writ application; none have merit. First, Hays claims, erroneously, that the opinion below creates a dispute among the circuits; this is incorrect and results from Hays's misreading of the opinions upon which he relies. Second, Hays argues that the Fifth Circuit's opinion conflicts with the plain language of § 548(c); this is a misinterpretation of the Fifth Circuit's opinion. Third, Hays claims that, despite the high standard set by the "clearly erroneous" standard of review of factual findings, this Court should reverse the Fifth Circuit's holding that the Bankruptcy Court's factual findings were not clearly erroneous; this issue is not worthy of writ consideration.

Finally, Hays complains that the appellate court ruled on issues not briefed; however, this is also incorrect.

Respondent Jimmy Swaggart Ministries ("JSM") also disputes Hays's factual allegations set forth in his statement of the case. As shown below, a number of these alleged factual statements are not supported by the record, are contrary to the factual findings of the trial court, or are contrary to the evidence introduced during the trial on the merits.

## II. OVERVIEW

This case involves the failed attempt of various corporations which were formed by Sam Recile to develop a shopping mall in Baton Rouge, Louisiana. In order to raise capital to finance the project, Recile violated state and federal securities laws. As a result, the United States Securities and Exchange Commission ("SEC"), filed a complaint in April of 1991 in the United States District Court for the Eastern District of Louisiana requesting injunctive relief as well as the appointment of a permanent receiver. Initially, a temporary restraining order was issued in the SEC lawsuit, ordering the debtor corporations and Recile to cease all operations and all fund raising activity. This temporary restraining order ("TRO"), lasted for approximately three days, at which time an amended TRO was entered by the district court with the consent of the parties. The amended TRO allowed the debtors to continue to operate and to raise funds from certain qualified investors as defined in the TRO and, specifically, to make payments to maintain the options on

real property, which were necessary for the success of the project.[1]

Prior to the institution of the SEC lawsuit, one of the debtor corporations had obtained an option on very valuable real property owned by JSM; JSM received approximately $800,000.00 in option payments for the period of July 1990 through April 1991.[2]

JSM learned of the institution of the SEC lawsuit and Recile's possible violations of state and federal securities laws through a newspaper article in a local newspaper in Baton Rouge, Louisiana.[3] After reading the article, JSM had its attorneys contact the SEC's counsel to determine if JSM could continue to negotiate with the debtor corporations and to receive the option payments. The attorney for the SEC refused to discuss the matter with JSM's attorney and merely directed him to review the court orders issued in the SEC lawsuit.[4] After reviewing the amended TRO and subsequent preliminary injunction, both of which provided that the debtors could continue to make option payments to the landowners, including JSM, JSM was satisfied that it could continue to negotiate with the

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[1] Appendix F to the Petition for Writ of Certiorari, Memorandum Opinion of the United States Bankruptcy Court for the Middle District of Louisiana, September 7, 1995 (hereinafter the "Bankruptcy Court Opinion"), p. 67a, p. 76a, and p. 107a.

[2] Bankruptcy Court Opinion, pp. 71a-73a, 75a.

[3] Appendix B to the Petition for Writ of Certiorari, Opinion of United States Court of Appeals for the Fifth Circuit, October 29, 2002 (hereinafter the "Fifth Circuit Opinion"), p. 11a.

[4] Bankruptcy Court Opinion, pp. 128a-129a.

debtors and to accept option payments and extension payments.[5]

There is no question or dispute that JSM's land was the most valuable property to be obtained by the debtors in furtherance of the project and that the maintenance of the option on JSM's land was absolutely essential for any hope of success for the project and the repayment of investors and other creditors. There is no question that, if the options on JSM's property were terminated, the project would immediately fail and none of the investors or creditors would be repaid.[6]

The debtors were allowed to continue to operate, raise funds and to make the option payments to the various landowners until the permanent injunction (which also appointed Hays as the permanent receiver) was rendered in the SEC lawsuit on July 29, 1992, a period of approximately fifteen months. The Bankruptcy Court found, as a matter of act, that at all times JSM complied with all district court orders issued in the SEC lawsuit; at no time did it engage in or assist Recile in any fraud, misrepresentation or any other wrongful acts.[7]

In September of 1992, Hays filed voluntary bankruptcy petitions on behalf of the debtor corporations; the cases were subsequently consolidated, and a liquidating plan for the debtor corporations was confirmed by the bankruptcy court. In February of 1994, Hays filed an

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[5] Fifth Circuit Opinion, p. 11a.

[6] Bankruptcy Court Opinion, pp. 117a-118a.

[7] Bankruptcy Court Opinion, pp. 68a-69a.

adversary complaint against JSM and others. In the adversary complaint, Hays sought to revoke the transfers made by the debtors, as well as transfers made by other third parties, pursuant to the provisions of 11 U.S.C. § 544 and 548. Under 544, Hays sought recovery under the Louisiana Revocatory Act.[8]

After an extensive and protracted trial on the merits, the bankruptcy court found in favor of JSM and dismissed all claims asserted by Hays. The bankruptcy court found, inter alia, that JSM was entitled to the defense under 11 U.S.C. § 548(c) because it had acted in good faith and given reasonably equivalent value to the debtors in consideration of the transfers it received. Additionally, the bankruptcy court found that Hays could not recover under the Louisiana Revocatory Act because under La.C.C. Art. 2040, transfers cannot be avoided if the transfers are made in the ordinary course of the obligor's business.[9]

Hays timely appealed to the district court, which reversed the decision of the bankruptcy court and rendered judgment in favor of Hays and against JSM.

A timely appeal was taken to the United States Fifth Circuit Court of Appeals by JSM. JSM requested that the decision of the district court be reversed and that the judgment of the bankruptcy court be reinstated and that the claims asserted by Hays under § 548 and § 544 (the Louisiana Revocatory Act), be dismissed.

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[8] Fifth Circuit Opinion, pp. 6a-7a.

[9] Bankruptcy Court Opinion, pp. 131a-134a.

The Fifth Circuit reversed the decision of the district court and reinstated the decision and judgment of the bankruptcy court dismissing all claims against JSM. The Fifth Circuit found that JSM met its burden of proof under 11 U.S.C. § 548(c) and it affirmed the decision of the bankruptcy court denying recovery under the Louisiana Revocatory Act finding that the transfers were made in the ordinary course of the debtors' business. The Fifth Circuit did not address the other issues raised on appeal.

## III. JSM DISPUTES THE "FACTS" ALLEGED BY HAYS IN HIS WRIT APPLICATION

JSM disputes the allegations made by Hays, on pages 1 and 2 of his Petition, that "the debtor corporations were the creation of Samuel J. Recile, who used them in a massive fraudulent scheme in which the debtors borrowed more than $15 million from scores of individuals throughout the country by issuing promissory notes promising short term returns (thirty to sixty days) of 100% or more."

The record in this case, as well as the findings of the bankruptcy court, indicate that the "investors" were individuals who knew that the project was a very high risk venture. They were given "double your money back" promissory notes to be paid within 30 to 60 days, plus 18% interest thereon. Additionally, these "investors," even after becoming aware of possible violations of the federal and state securities laws by Recile and the possible fraud on the part of Recile, continued to invest money in the debtor

corporations, or to send money directly to JSM in order to maintain the options on the property.[10]

Hays incorrectly maintains that Recile secretly created new corporate entities to continue his unlawful money-raising activities. There is no evidence in the record to substantiate this claim, and no such findings were made by the trial court. Indeed, the orders of the district court allowed Recile to continue to raise funds from investors.[11]

Hays further miscategorizes some of the options which were granted by JSM to the debtor corporations. Prior to 1992, all of the options and extensions were for periods of three to six months and were entered into under normal business terms for reasonable consideration.[12]

Commencing in December of 1991 and January of 1992, under the belief and advice that the permanent financing to exercise the options was coming forthwith, JSM entered into various short term option agreements with Bluebonnet Transfer Corporation. Bluebonnet Transfer Corporation was a separate entity which was not one of the debtor corporations. JSM received payments from Bluebonnet Transfer Corporation ("Bluebonnet") from January of 1992 through April of 1992. Under the terms of the agreements, which are set forth in the bankruptcy court's findings of facts,[13] in order to maintain the options

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[10] Bankruptcy Court Opinion, pp. 68a, 76a-78a.

[11] Record on Appeal to Fifth Circuit, Defendant's Exhibits 115, 116 and 118; and Plaintiff's Exhibits A-2, A-3, A-4 and A-8.

[12] Bankruptcy Court Opinion, pp. 71a-76a, 78a-82a, 84a-94a.

[13] Bankruptcy Court Opinion, pp. 94a-99a.

on the property (comprising more than 127.5 acres),[14] which were granted for periods of one week to two weeks, Bluebonnet was required to make payments varying from $7,500.00 per day to $10,000.00 per day. JSM had requested a more substantial option fee to be paid in advance for a period of three to six months; however, Bluebonnet indicated to JSM that the permanent financing was coming shortly and that it would prefer the method of making the daily payments for short-term extensions until the funding arrived.[15] The transfers of funds from Bluebonnet and other third parties, non-debtors, cannot be avoided under either the bankruptcy code or the Louisiana Revocatory Act.[16]

Hays further states that, Recile used copies of the fully executed but escrowed sales as well as copies of his phony loan commitments to mislead investors into believing that his project owned the land and had obtained permanent financing to build the shopping mall. This is not correct either. The record in this case does not support this statement. There was some evidence indicating that some of the loan commitments were not viable, however,

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[14] Bankruptcy Court Opinion, p. 68a.

[15] Bankruptcy Court Opinion, pp. 97a-98a.

[16] Under 11 U.S.C. § 548(a) only transfers of property of the debtor can be avoided. *Brown v. First National Bank of Little Rock, Arkansas*, 748 F.2d 490 (8th Cir. 1984); *Chase and Sandborn Corp. v. Sanchez*, 813 F.2d 1177 (11th Cir. 1987); *De Angio v. De Angio*, 544 F.2d 863 (8th Cir. 1977); *Coral Petroleum, Inc. Banque Paribas-London, et al.*, 797 F.2d 1351 (5th Cir. 1986). Additionally, under the Louisiana Revocatory Act, the transfers must deplete the debtor's estate and, therefore, must be property of the debtor. *Premier Bank National Association v. Stout*, 627 So.2d 1888 (La. App. 3rd Cir. 1994).

William Hays, when he served as special master, never advised the district court that the loan commitments were not viable or legitimate.[17]

Additionally, Hays is incorrect in asserting that JSM received $50,000 in violation of the permanent injunction. Subsequent to the appointment of Hays as the receiver for the debtors, a new corporation was formed, S'Avancer, Ltd., which was not owned by Recile nor any of the other debtor corporations. S'Avancer entered into a new option agreement with JSM and the funds received by JSM, were not the funds of the debtors or Recile. The bankruptcy court found that JSM acted in good faith in its dealings with S'Avancer in receiving the post-receivership funds from third parties.[18]

Hays further maintains that the debtors were at all times insolvent. JSM denies this allegation and maintains, and has maintained, throughout this proceeding that Hays failed to prove that the debtors were insolvent on the dates that the transfers were made.

Hays further states that JSM did not brief or argue the "ordinary course of business" defense to the Fifth Circuit. This is also incorrect. JSM, in a number of places, argued that the trial court was correct in substantiating this defense and raised all defenses under the Louisiana Revocatory Act.[19]

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[17] Bankruptcy Court Opinion, p. 128.

[18] Bankruptcy Court Opinion, pp. 108a-110a.

[19] Fifth Circuit Opinion, p. 20a; JSM (Appellant's) Brief to Fifth Circuit, pp. 14, 23 and 90.

## IV. THE FIFTH CIRCUIT'S DECISION IS CONSISTENT WITH THE OTHER CIRCUIT COURTS OF APPEALS AND SETS FORTH THE PROPER CRITERIA IN CONSIDERING GOOD FAITH AND REASONABLY EQUIVALENT VALUE UNDER § 548(c) OF THE BANKRUPTCY CODE

### A. GOOD FAITH

In Section I of the Petition concerning the good faith requirement under § 548(c), Hays misstates the law and the holdings of other circuit courts of appeals. Hays maintains that,

> "All seven circuits that have considered the issue have adopted an objective standard for good faith under § 548(c) . . . [Cites omitted.] . . .
>
> All of these circuits recognize that a transferee acts in bad faith when he has sufficient knowledge to place a reasonably prudent person on notice to the debtor's possible insolvency or fraud but does nothing."[20]

None of the circuit courts of appeal have taken such a simplistic approach in determining whether a transferee is acting in good faith. A review of the decisions on this point, including *Brown v. Third National Bank (In re: Sherman)*, 67 F.3d 1348, 1353 (8th Cir. 1995); *Huffman v. Commerce Security Corp. (In re: Harbour)*, 845 F.2d 1254, 1258 (4th Cir. 1988); *In re: Agricultural Research and Technical Group*, 916 F.2d 528, 535 (9th Cir. 1990); *In re: M&L Business Machines Co., Inc.*, 84 F.3d 1330, 1338 (10th Cir. 1996), *cert. denied*, 519 U.S. 1040, 117 S.Ct. 608, 136 L.Ed.2d

[20] See pages 7 and 8 of Petition for Writ of Certiorari.

534 (1996) (discussing the good faith requirement under Section 548(c), the court stated, 'resolution of this issue requires a determination of whether the facts satisfy the proper legal standard, a mixed question of law an fact (cites omitted). In these circumstances, because the question of good faith is primarily factual, we will review the findings of the bankruptcy court for clear error, id. p. 1338), indicate that the federal appellate courts employ an intent factual scrutiny to determine the good faith of the transferee. All of the appellate courts recognize that the definition of "good faith" is not defined under the bankruptcy code and that good faith must be determined on a case-by-case basis.

This is exactly what was done in this case. The bankruptcy court[21] and the court of appeals considered the circumstances surrounding the transfers and the conduct of the transferee.[22] They considered: (1) whether the transferee

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[21] Bankruptcy Court Opinion, pp. 113a-119a, and 126a-131a.

[22] "The heart of the bankruptcy court's conclusion lies then, in the first set of questions – the transferee's state of mind. Once again, the bankruptcy court's findings are comprehensive, cogent and entitled to the respect due them under the clear error standard. We point here only to the most telling of a voluminous listing of findings. In regard to JSM's knowledge of the debtors corporations' insolvency, the bankruptcy court found, 'at the time that the transfers occurred, JSM had no way of knowing that the debtors were insolvent'. With regard to JSM's knowledge of the debtor corporations' fraudulent activities, Judge Brown found that JSM had read newspaper accounts of the SEC suit against Recile. Finally, with regard to JSM's duty of inquiry, Judge Brown found that JSM upon reading – and being duly alarmed by – these newspaper stories, undertook its own investigation, contacting the SEC and the federal district court and eventually receiving assurances from the district court that JSM could continue to receive option payments from Recile's corporations.

(Continued on following page)

was an insider of the debtor; (2) whether the transferee held a special position or had special knowledge concerning the affairs of the debtor which would give it an undue advantage over other parties; (3) whether the transfer involved all or substantially all of the debtor's assets; and most importantly, (4) whether the transfers were for fair and adequate consideration.

The Fifth Circuit performed a thorough intensive analysis of the facts and of intent in determining that JSM acted in good faith.[23]

The law review commentators also agree with the analysis conducted by the Fifth Circuit in this case. In Epstein Nickles White, *Bankruptcy, Practitioner Treatise Series*, Vol. 2, Section 6-46 to 9-30 (West Publishing Co. 1992), the commentators note that:

> "Here we focus on good faith for purposes of § 548(c). It is an indispensable element of this saving provision, but is not susceptible of precise definition. Good faith is a fact question that depends on the particular circumstances of each

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Based on its findings, the bankruptcy court's resulting legal conclusion is unproblematic." Fifth Circuit Opinion, p. 12a. [Emphasis added.]

[23] "This court has lacked either occasion or disposition to attempt to formulate such a definition for purposes of § 548(c). Moreover, the atypical posture of the fraudulent conveyance claim here, i.e., *the debtors' payments to an unaffiliated third party in an arms length transaction,* counsels caution in attempting to propound a broad rule concerning good faith for § 548(c). It is enough for present purposes to rely on the bankruptcy court's conscientious findings and conclusions." Fifth Circuit Opinion, p. 12a; 5 *Collier on Bankruptcy*, p. 548.07[2] [a] (15th Ed. 2002).

> case. Generally speaking, however, good faith requires an arms-length transaction in which the transferee herself acts honestly and without malice or fraudulent design."

In this case, there is no question that JSM was not part of nor even aware of Recile's or the debtors' improper activities.

## B. NO CONFLICT WITH OTHER CIRCUITS CONCERNING VALUE

Hays argues that an unexercised option to purchase real property does not convey any value to the optionee and that the optionor therefore does not give "value" under § 548 of the bankruptcy code. The Fifth Circuit discussed the value of options and the option contracts in the course of its decision and rejected this position. Hays's heavy reliance on the Third Circuit decision in *In re: R.M.L., Inc.*, in an erroneous attempt to argue that a circuit conflict exists, is misplaced.[24]

In *R.M.L.*, the Third Circuit considered the value of a loan commitment which was never funded and contained conditions that the debtor could never have met because the commitment letter was "so conditional" and "highly conditional" because it was expressly contingent upon actions of third parties.[25] The options here were not conditional and were not dependent upon the actions of third parties; all the options did were to give the potential purchasers exclusive rights to buy the property if they

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[24] *In re: R.M.L., Inc.*, 92 F.3d 139 (3rd Cir. 1996)

[25] 92 F.3d at 142.

came to the closing with the necessary funds. The Third Circuit in *R.M.L.* found that the commitment itself had value and that the bank issuing the commitment had given value even though the loan was never funded and the creditors of the debtor did not receive any direct economic benefit from any loan proceeds.[26] There is nothing in the Fifth Circuit's opinion, below, that is inconsistent with *R.M.L.*

The Fifth Circuit's decision is also in line with the Sixth Circuit's decision of *In re: Chomakos*,[27] In *In re: Chomakos*, the Sixth Circuit held that the possibility of winning at a gambling establishment constituted reasonably equivalent value as to the wagers made and lost by the debtor,[28] Certainly, in the instant case, the debtors received

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[26] "Mellon established a valid contractual basis for retention of the $125,000. The August 9, 1991 proposal letter provided for a good faith deposit in the amount and Mellon established to my satisfaction that such agreement was of an ordinary commercial nature and that Mellon actually and reasonably incurred out of pocket expenses through the cessation as take down examination in excess of the $125,000 deposit such as warranted the retention of the deposit under the agreement. The contractual nature of this relationship is entitled to some degree of respect in the balance. Additionally, . . . the evidence indicated that the parties were at arms length at the time that the proposal was issued and accepted. Finally, a three month period passed between the transfer of the initial $125,000 and the termination of the proposed transaction; **there was adequate time for some degree of the types of indirect benefits alleged by Mellon to accrue with respect to this initial transfer.**" id. pp. 145-146. [Emphasis added.]

[27] *In re: Chomakos*, Docket No. 94-1712, 69 F.3d 769 (6th Cir. 11/13/95).

[28] "The point in time as to which we must determine whether Mr. and Mrs. Chomakos received property of reasonably equivalent value in exchange for the money they wagered at the casino is the point at which their bets were placed. See *In re: Morris Communication of North*

(Continued on following page)

far more benefit from an option on real property than the debtors received in the *Chomakos* case, for here, the debtors were given the exclusive right to buy the property, preventing other potential purchasers from buying it, and preventing the seller from marketing it to others.

The decision of the Fifth Circuit concerning valuation is completely in line with the cases cited by Hays on page 20 of the Petition for Writ of Certiorari.

The cases cited by Hays have held that the determination of value is made on a case-by-case basis and is a factual issue. In *In re: West Dor, Inc.*, 996 F.2d 237 (10th Cir. 1993), cited by Hays, the debtor corporation had pledged its assets in order to secure the debt of its parent corporation. The transferee bank was unable to show that any value was received by the debtor subsidiary in consideration of the transfers. The Tenth Circuit found no error in the trial court's factual determination that the transferee bank failed to prove that it had given any value.

In *Covey v. Commercial National Bank of Peoria*, 960 F.2d 657 (7th Cir. 1992), the court considered whether the debtor, a guarantor on the debt of its parent corporation, received value for satisfying a portion of the debt owed to the bank. Again, the Seventh Circuit held that this was a factual issue and that the trial court's findings would not

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*Carolina, Inc.*, No. 88-3060, 88-3062, 914 F.2d 458, 466 (4th Cir. 9/13/90), quoting *Collier on Bankruptcy*, Sec. 548.09 at p. 116 (15th Ed. 1984), as follows: the critical time is when the transfer was made. Neither subsequent depreciation in or appreciation of value of consideration affects the question of when reasonably equivalent value is given." Id. pp. 770-771.

be upset absent a showing of clear error. The court went through a detailed analysis of the probability of the amount that the debtor guarantor would have to pay under the contingent liability.

In the *Covey* case, the debtor had paid the bank $1.47 million. The trial court underwent a detailed analysis of the value received by the debtor and determined that the debtor received approximately $1.2 million in value and only ordered the bank to return the difference. Again, this was a factual determination made by the trial court.

Hays also cites the case of *In re: Grand Chevrolet, Inc.*, 25 F.3d 728 (9th Cir. 1994). First, that case involved preferential transfers under 11 U.S.C. § 547 and did not involve the determination of value under § 548. However, the court held that this was a factual issue and that the transferee was required to prove the value of the transfer.

In *In re: Jet Florida Systems, Inc.*, 861 F.2d 1555 (11th Cir. 1988), the court was also required to make a factual determination concerning the value of the transfer received by the debtor. In that case, the value was determined based upon the market value of the goods and services and the new credit received by the debtor.

Similarly, the value received by the debtors in the instant case was determined based upon the value of the options at the time the transfers were made.

### C. VALUE OF OPTION ON REAL PROPERTY; REAL RIGHT

Louisiana law has always recognized the value of an option on real property. The option confers a right upon the prospective vendee to perfect the sale, which right may

be specifically enforced. This right is an incident of ownership, a real right affecting the immovable property which is the subject of the contract. The seller may not sell the property to a third party in derogation of the right of the buyer under a prior option. The option gives the buyer the exclusive right to demand specific performance of the sale. Professor Yiannopoulos, *Real Rights in Comparative Law*, part 1. 23 La.L.R. 166, 138 (1963). *George v. Manhattan Land and Fruit Co.*, No. 6079, 51 F.2d 28, 30 (5th Cir. 6/29/31).

On an analogous issue, this Honorable Court held in *Bank of America National Trust and Savings Association v. 203 North LaSalle Street Partnership*, 526 U.S. 434, 1119 S.Ct. 1141, 143 L.Ed.2d 607 (1999), that in the context of the absolute priority rule under the cram down provisions of Chapter 11 of the United States Bankruptcy Code (11 U.S.C. § 1129), that the plan which gave the old equity owners of a reorganized debtor corporation the exclusive right to purchase the new stock interest or to make new capital contributions in order to retain the old stock interest was violative of the absolute priority rule. This Court reasoned that the exclusive right given to the old equity holder constituted property with value which violated the absolute priority rule. The Court stated,

> "But before the debtor's plan was accepted, no one else can propose an alternative one, and after its acceptance, no one else could obtain equity in the reorganized entity. At the moment of the plan's approval, **the debtor's partners necessarily enjoyed an exclusive opportunity that was in no economic sense distinguishable from the advantage of the exclusively entitled offerer or option holder. This opportunity should first of all be treated as an**

> **item of property in its own right.** *In re: Coltex Lube Central Three Partners, L.P.*, 138 F.3d at 43 (exclusive right to purchase post petition equity is in itself property); *In re: Bryson Properties, XVIII*, 961 F.2d at 504, *Com & Nate Shoes No. 2, Inc. v. First Bank*, 908 F.2d 1351, 1360 (Ct. App. 7th Cir. 1990); D. Baird, *The Elements of Bankruptcy*, 261 (Rev. Ed. 1993). The right to get an equity interest for its fair market value is property as the word is ordinarily used. Options to acquire an interest in a firm, even at its market value, trade for a positive price . . .
>
> Given that the opportunity is property of some value, the question arises why old equity alone should obtain it, not to mention at no cost whatever." 526 U.S. at 455-456. [Emphasis added.]

In the *LaSalle* case, this Court clearly recognized that an exclusive right or option to purchase something of value, in that case stock ownership in a reorganized company, was itself valuable property. Similarly, the exclusive right to purchase real property is also a property right which has value.

All of the circuits agree that the determination of value under § 548 is a factual question which must be determined on a case-by-case basis and that the clearly erroneous standard is applied to the trial court's findings.

### D. CRITERIA THAT HAYS WOULD HAVE THIS COURT ESTABLISH, WOULD CAUSE HAVOC IN COMMERCIAL TRANSACTIONS

Hays asks this Court to establish a totally amorphous criteria that could not be met by any transferee. Hays proposes an economic impact test. For example, if a car

dealer sells the debtor a new vehicle for $20,000, its market value, this would obviously be a fair transaction in which equal values are exchanged.

However, under Hays's theory, the inquiry would not end at this point. Rather, Hays would require the transferee to conduct an extensive economic analysis to determine the value of the use of the vehicle, not only to the debtor, but also to the debtor's creditors. The car dealership would have to prove that the vehicle was used to generate revenues which were used to pay the creditors. The transferee would have to quantify the amount of funds so generated in order to determine the "extent of the value given" by the dealership. Obviously, this would be an impossible task. This Court can well imagine the chaos and havoc that would be created in the commercial world if this Court were to render such a decision.

## E. FIFTH CIRCUIT DECISION FOLLOWS THIS COURT'S DECISION ON VALUE

In *Associates Commercial Corporation v. Rash*, 520 U.S. 953, 117 S.Ct. 1879, 138 L.Ed.2d 148 (1997), this Court held that the proper standard in determining value is the replacement value of the property, i.e., *the costs that the debtor would incur to obtain a like asset for the same proposed use*. The analysis performed by JSM's expert, and adopted by the Fifth Circuit and the trial court, used this exact methodology. Dr. Aguilar determined what it would cost to maintain an option on similar property with similar values and found that the option payments were therefore reasonable.

Similarly, the transferee is only required to show the market value of the property or right transferred to the

debtor under § 548. It would be virtually impossible for any transferee to show that the specific transfer resulted in an economic gain to any of the debtor's creditors. How could this be done in a consumer transaction in which a vehicle or other item is merely used for enjoyment purposes or non-business related purposes? Is the car dealership then in bad faith because it knew or suspected that the vehicle was a recreational vehicle and not being used for business purposes? Would the car dealer then have to hire an expert economist to prove the value of the vehicle to the debtor and the debtor's creditors? What if the debtor never uses the car? This Court's decision in *Rash* requires no such analysis.

### F. HAYS ASSERTS A FALSE PREMISE CONTRADICTED BY THE RECORD

Hays erroneously maintains that the options had no value because they were impossible for the debtors to exercise. There is no factual basis in the record for this assertion. No evidence was introduced during the trial to support this position and no findings were ever made by the trial court that it would have been impossible for the debtors to exercise the options.

Indeed, as the evidence that was introduced indicates, the district court, which presided over the SEC lawsuit, was ever hopeful that the debtors would obtain the necessary financing in order to fund the options and repay the investors.[29] The SEC lawsuit was commenced in April of 1991 and continued until the permanent injunction was

[29] Bankruptcy Court Opinion, pp. 127a-128a.

issued appointing Hays as the receiver on July 29, 1992, approximately fifteen months later. During this period of time, the SEC, the debtors, Sam Recile and Hays, himself, were all hopeful that Recile would obtain the necessary financing.[30] Additionally, Hays was appointed as the special master in order to investigate the financial affairs of the debtor corporations. During this period of time, from April 1991 through July 29, 1992, Hays, as special master, filed a number of interim reports with the federal district court in the SEC lawsuit. *In none of these reports did Hays ever indicate that it would be impossible to obtain the necessary financing or that the debtors would not be able to exercise the options on the property.* The trial court found, as a matter of fact, that:

> "The debtors were being investigated at the time by the SEC, the special master [Hays], and the special master's attorney. None of them ever advised JSM of any improper conduct or any wrongful actions on the part of the debtor. The reports submitted to the federal district court did not indicate that the project was not feasible or viable or that it would be impossible for the debtors to obtain permanent financing for the project. Hays testified that he never advised the federal district court that the purported lending institutions were not legitimate or capable of funding the required loans to the debtors".[31]

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[30] Bankruptcy Court Opinion, p. 68a, para. 7; p. 76a, subpart H, the "SEC lawsuit", para. 37-45; p. 116a.

[31] Bankruptcy Court Opinion, p. 128a.

## V. HAYS'S DUE PROCESS RIGHTS WERE NOT VIOLATED

There is absolutely no validity in Hays's claim that his due process rights were violated, as the record clearly shows.

Hays initially filed the adversary complaint against JSM alleging, as one of the grounds for recovery, a claim under 11 U.S.C. § 544(b)(1). Section 544(b)(1) allows a bankruptcy trustee to pursue a claim under applicable state law. In this case, Hays pursued the claim under the Louisiana Revocatory Act (the "Act"), which allows a creditor to avoid a transfer made by its debtor (obligor) that causes or increases the obligor's insolvency. La.C.C. Art. 2040, which is part of the Act, provides that the transfer cannot be avoided if it is made in the ordinary course of the obligor's business.

When Hays initially filed his claim under the Act, he did so subject to all of the defenses contained in the Act. Hays advises this Court that JSM never argued the Art. 2040 defense issue. This is not correct. During the course of the trial, both Hays and JSM introduced evidence concerning the nature of the venture.[32] The evidence clearly showed that the transfers were not only made in the ordinary course of the debtors' business, but were absolutely

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[32] Testimony of Hays on direct and cross examination contained in Vol. 22 of trial transcript. Hays discussed the entire project including the necessity of the options on JSM's property. Indeed, Hays testified that when he was first appointed as the special master, he was concerned that the option's on JSM's land had elapsed. Trans. Vol. 22, pp. 31-34.

essential to the success of the project.[33] Obtaining these options was clearly within the normal scope of the debtors' business.

Hays complains about a footnote in the bankruptcy court's opinion in which the bankruptcy court cites a reported case in which Recile was recognized as a real estate "wizard."[34] This is not a case of judicial notice; courts are empowered to rely upon the decisions of other courts, for that is the basis of the common law. There is nothing wrong with citing an earlier court opinion that dealt with Recile and his real estate ventures; the entire case involved a real estate venture, and the information was pertinent and useful in showing Recile's long-time involvement in the real estate field. The bankruptcy court did not solely rely on this opinion in rendering its decision.

There was more than sufficient evidence introduced to support the trial court's finding that the transfers were made in the ordinary course of business of the real estate investment. The project, by definition, required the obtaining of property for the mall site. Ironically, the bankruptcy court relied primarily upon the testimony of Hays, himself, to decide this issue.

The provisions of La.C.C. Art. 2040 are inherent in the claim pursued by Hays under the Act and were raised at

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[33] Bankruptcy Court Opinion, p. 134a, in which the bankruptcy court stated, "JSM was not involved in Recile's fraudulent activities and received fair consideration for giving the debtors options to ***purchase land necessary to complete the mall project which was the whole point of the debtor's business. The transfers were in the ordinary course of business and may not be annulled.***"

[34] Bankruptcy Court Opinion, p. 130a, fn. 9.

all levels during the trial and appeal. Hays's due process rights were not violated. The bankruptcy court thoroughly discussed this issue.[35] This is a non-issue in this case.

## VI. CONCLUSION

This case does not meet the requirements for the granting of a writ of certiorari. There is no conflict in the circuits. The interpretation that Hays gives Bankruptcy Code § 548 is wrong, and would lead to disastrous consequences. The Fifth Circuit, relying upon the factual findings of the bankruptcy court and applying the clearly erroneous standard, properly found that the factual findings were appropriate. The Fifth Circuit did not violate Hays's due process rights; all the issues were properly before the court.

For the foregoing reasons, it is respectfully requested that the Petition for Writ of Certiorari be denied.

Respectfully submitted,

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[35] Bankruptcy Court Opinion, pp. 133a-134a. The Bankruptcy Court indicated that, ab initio that, "finally, JSM asserts that the exception contained in La.C.C. Art. 2040 is applicable to the receiver's claims."

# APPENDIX A

## Text of Bankruptcy Code and Louisiana Civil Code Involved in This Case

**Title 11 United States Code, Section 544 (West 2003)**
**Trustee as lien creditor and as successor to certain creditors and purchasers.**

(a) The trustee shall have, as of the commencement of the case, and without regard to any knowledge of the trustee or of any creditor, the rights and powers of, or may avoid any transfer of property of the debtor or any obligation incurred by the debtor that is voidable by –

(1) a creditor that extends credit to the debtor at the time of the commencement of the case, and that obtains, at such time and with respect to such credit, a judicial lien on all property on which a creditor on a simple contract could have obtained such a judicial lien, whether or not such a creditor exists;

(2) a creditor that extends credit to the debtor at the time of the commencement of the case, and obtains, at such time and with respect to such credit, an execution against the debtor that is returned unsatisfied at such time, whether or not such a creditor exists; or

(3) a bona fide purchaser of real property, other than fixtures, from the debtor, against whom applicable law permits such transfer to be perfected, that obtains the status of a bona fide purchaser and has perfected such transfer at the time of the commencement of the case, whether or not such a purchaser exists.

(b)(1) Except as provided in paragraph (2), the trustee may avoid any transfer of an interest of the debtor in property or any obligation incurred by the debtor that is voidable under applicable law by a creditor holding an unsecured claim that is allowed under section 502 of this title or that is not allowable only under section 502(e) of this title.

(2) Paragraph (1) shall not apply to a transfer of a charitable contribution (as that term is defined in section 548(d)(3) that is not covered under section 548(a)(1)(B), by reason of section 548(a)(2). Any claim by any such person to recover a transferred contribution described in the preceding sentence under Federal or State law in a Federal or State court shall be preempted by the commencement of the case.

**Title 11 United States Code, Section 548 (2003)**
**Fraudulent transfers and obligations**

(a)(1) The trustee may avoid any transfer of an interest of the debtor in property, or any obligation incurred by the debtor, that was made or incurred on or within one year before the date of the filing of the petition, if the debtor voluntarily or involuntarily –

(A) made such transfer or incurred such obligation with actual intent to hinder, delay, or defraud any entity to which the debtor was or became, on or after the date that such transfer was made or such obligation was incurred, indebted; or

(B)(i) received less than a reasonably equivalent value in exchange for such transfer or obligation; and

(ii)(I) was insolvent on the date that such transfer was made or such obligation was incurred, or became insolvent as a result of such transfer or obligation;

(II) was engaged in business or a transaction, or was about to engage in business or a transaction, for which any property remaining with the debtor was an unreasonably small capital; or

(III) intended to incur, or believed that the debtor would incur, debts that would be beyond the debtor's ability to pay as such debts matured.

(2) A transfer of a charitable contribution to a qualified religious or charitable entity or organization shall not be considered to be a transfer covered under paragraph (1)(B) in any case in which. –

(A) the amount of that contribution does not exceed 15 percent of the gross annual income of the debtor for the year in which the transfer of the contribution was made; or

(B) the contribution made by the debtor exceeded the percentage amount of gross annual income specified in subparagraph (A), if the transfer was consistent with the practices of the debtor in making charitable contributions.

(b) The trustee of the partnership debtor may avoid any transfer of an interest of the debtor in property, or any obligation incurred by the debtor, that was made or incurred on or within one year before the date of the filing of the petition, to a general partner in the debtor, if the debtor was insolvent on the date such transfer was made or such obligation was incurred, or became insolvent as a result of such transfer or obligation.

(c) Except to the extent that a transfer or obligation voidable under this section is voidable under Section 544, 545 or 547 of this title, a transferee or obligee of such a transfer or obligation that takes for value and in good faith has a lien on or may retain any interest transferred or may enforce any obligation incurred, as the case may be, to the extent that such transferee or obligee gave value to the debtor in exchange for such transfer or obligation.

(d)(1) For the purposes of this section, a transfer is made when such transfer is so perfected that a bona fide purchaser from the debtor against whom applicable law permits such transfer to be perfected cannot acquire an interest in the property transferred that is superior to the interest in such property of the transferee, but if such transfer is not so perfected before the commencement of the case, such transfer is made immediately before the date of the filing of the petition.

(2) In this section –

(A) "value" means property, or satisfaction or securing of a present or antecedent debt of the debtor, but does not include an unperformed promise to furnish support to the debtor or a relative of the debtor;

(B) a commodity broker, forward contract merchant, stockbroker, financial institution, or securities clearing agency that receives a margin payment, as defined in section 101, 741, or 761 of this title, or settlement payment, as defined in section 101 or 741 of this title, takes for value to the extent of such payment;

(C) a repo participant that receives a margin payment, as defined in section 741 or 761 of this title, or settlement payment, as defined in section 741 of this title,

in connection with a repurchase agreement, takes for value to the extent of such payment; and

(D) a swap participant that receives a transfer in connection with a swap agreement takes for value to the extent of such transfer.

(3) In this section, the term "charitable contribution" means a charitable contribution, as that term is defined in section 170(c) of the Internal Revenue Code of 1986, if that contribution –

(A) is made by a natural person; and

(B) consists of –

(i) a financial instrument (as that term is defined in section 731(c)(2)(C) of the Internal Revenue Code of 1986); or

(ii) Cash.

(4) In this section, the term "qualified religious or charitable entity or organization" means –

(A) an entity described in section 170(c)(1) of the Internal Revenue Code of 1986; or

(B) an entity or organization described in section 170(c)(2) of the Internal Revenue Code of 1986.

**Louisiana Civil Code of 1870, Book III, Title IV, Chapter 12, Sec. 1, Arts. 2036-2043 (West Group 2001) – Louisiana Revocatory Act.**

**La.C.C. Art. 2036. Act of the Obligor that Causes or Increases His Insolvency**

An obligee has a right to annul an act of the obligor. or the result of a failure to act of the obligor, made or effected after the right of the obligee arose, that causes or increases the obligor's insolvency.

**La.C.C.Art. 2040. Contract made in course of business.**

An obligee may not annul a contract made by the obligor in the regular course of his business.